Economic Update Italy

2 October 2012

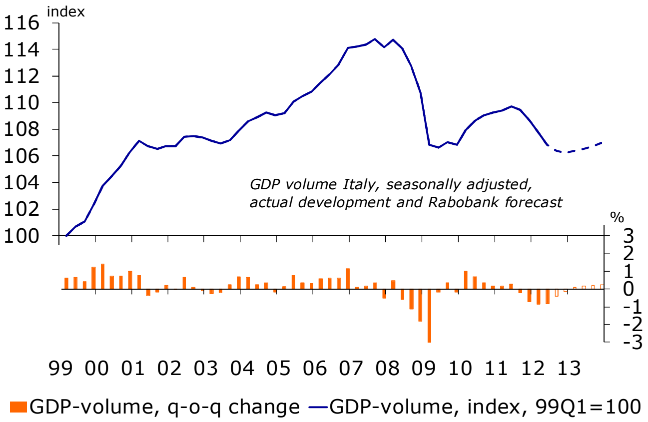
Cautious signs of stabilisation

Year-on-year change (%)	'11	'12	'13
Gross Domestic Product	0.5	-2¼	-¼
Private consumption	0.4	-3½	-¾
Government consumption	-0.9	-1	-1
Investment	-1.2	-9	-2½
Exports	6.3	1	3½
Imports	1.0	-7¼	3¼
Inflation	2.9	3	1¾
Unemployment (%)	8.4	10¾	11
Government balance (% GDP)	-3.9	-3	-2
Government debt (% GDP)	120.0	124	125

Source: Reuters EcoWin, Rabobank

The Italian economy will remain in recession in the second half of the year, but we expect the pace of contraction to moderate. In 12Q2, the economy recorded its fourth quarterly decline and the GDP volume almost reached the low-point of the previous recession in 2009. With a decline in both employment and the labour force over the three months to August, the unemployment rate has remained constant. Consumer and producer sentiment has stabilised in recent months, but remains at very low levels that point to further falls in economic activity. In this environment, the government is having a hard time to reduce its budget deficit.

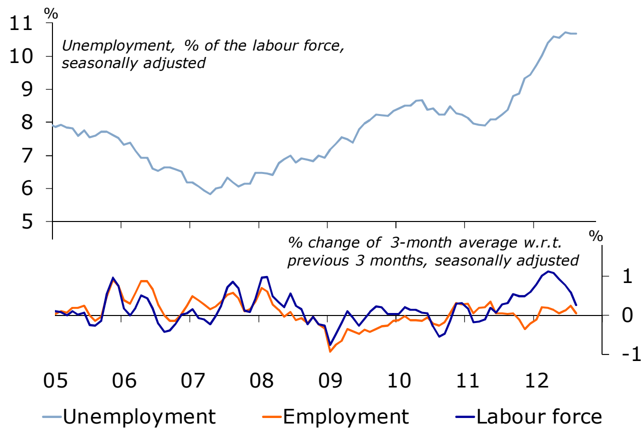
Four quarters of recession and counting



Source: Reuters EcoWin, Rabobank

At -0.8% q-o-q, the second estimate of 12Q2 Italian GDP was slightly lower than the initial estimate of -0.7% and matched the contraction of the first quarter. The recession is now four quarters old and the level of GDP is almost back at the low-point reached during the recession in 2009. Private consumption and fixed asset investment continued to decline rapidly in 12Q2 and exports grew only marginally. In the second half of the year, slow global economic growth will continue to hold back the expansion of exports. Further austerity will continue to push down domestic demand, both directly through lower government spending and indirectly by lowering household disposable income.

Pause in rising unemployment



Source: Reuters EcoWin

In August, the unemployment rate held steady at 10.7% for the third month in a row. This is not the result of rising employment. In fact, employment fell on a monthly basis over the last three months. But with the labour force declining at a similar pace, a further rise in the unemployment rate was prevented. The falling labour force follows a sharp rise in the first months of the year, which was the result of a rise in the statutory retirement age. Now that the effect of this policy has waned, the evolution of the labour force will be determined by the weakness of the economy, with a lack of job-creation discouraging people to keep looking for work.

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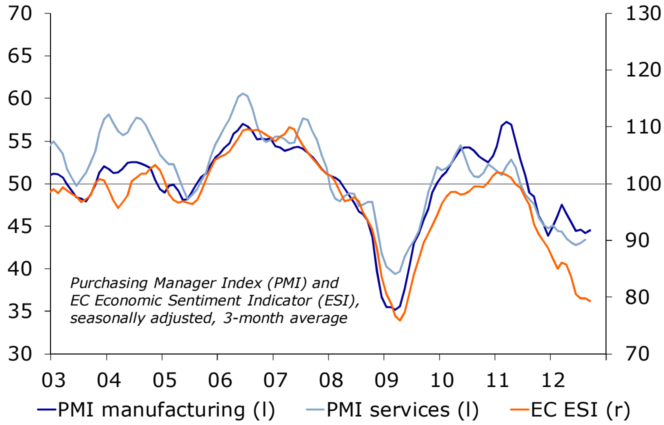
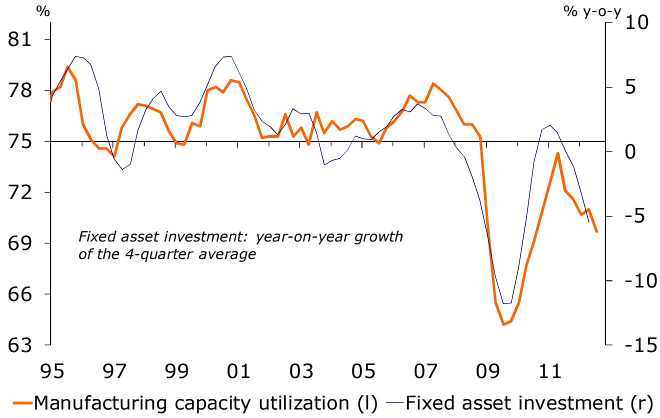
Fall in sentiment moderates



Source: Reuters EcoWin

The Economic Sentiment Indicator has held roughly steady in the five months to September. A similar stabilisation can be observed in the purchasing manager indices for manufacturing up to September and for services up to August. This stabilisation keeps these sentiment indicators at very depressed levels, which suggests that the economy remains in recession. Improvement in sentiment going forward will crucially depend on developments in the European crisis. If the Italian bond market retains its relative calm after Spain finally requests a bailout from the European rescue mechanism, we might see a drop in pessimism.

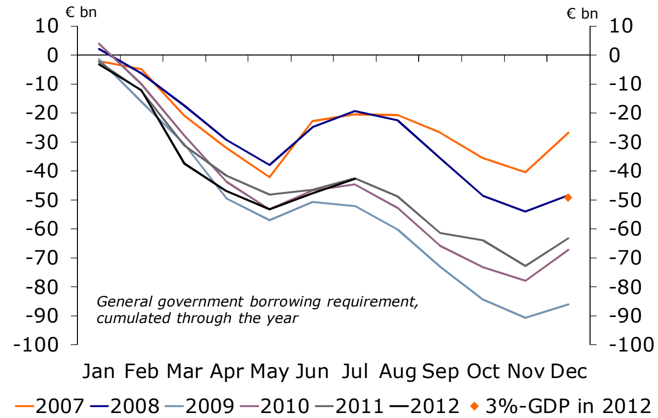
Investment boom a long way off



Source: Reuters EcoWin

With the fall in economic activity, the capacity utilisation rate in the manufacturing industry has declined rapidly over the past quarters. Given our expectation of continued recession, a further fall is likely. On top of that, the economic outlook remains highly uncertain, both because of the European debt crisis in general and because of the fact that Italian elections will be held before April 2013. The Italian banks are under increased pressure due to doubts about the creditworthiness of the sovereign and adverse economic developments. All these dynamics combined make a return to investment growth very unlikely for some time to come.

Lower expenditures have to lower the budget deficit



Source: Reuters EcoWin, Rabobank

The government borrowing requirement for the first seven months of the year was unchanged from 2011. To reduce the deficit to the 3%-GDP that is demanded in the excessive deficit procedure, the government will have to shave at least EUR 14bn off the deficit in the second half of the year. The own target of 1.7% will certainly not be met. A positive development in the budgetary strategy was that the government has been able to identify enough possibilities for expenditure reduction to be able to postpone a rise in the VAT-rate that was planned for October. But the reduction in spending is clearly needed right now to push down the budget deficit further.

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